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ABSTRACT

There exists a clearly and amply documented need for an alternative to the property tax as a means of supporting public education, and many fiscal experts have expressed themselves in favor of the municipal income tax as a recourse. This analysis attempts to demonstrate that since additional revenues are needed for local governments and an inequitable and destructive revenue system is urgently in need of reform, the optimum solution to the property tax dilemma may be the municipal income tax. Following an introductory discussion of the concept of taxation equity in terms of the "benefit received" and "ability to pay" principles, the discussion explores the relevance of these principles to the financing of public education. A summary description of the municipal income tax recounts its history, describes its characteristics, and discusses its probable future. A list of findings and recommendations resulting from analysis of existing local income taxes, review of relevant literature, and consideration of the community needs and characteristics is provided. (Author)

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A COUNTY INCOME TAX FOR EDUCATION?

A Report Prepared for the
Monroe County Educational Planning Committee

by

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EA 003 922

Table of Contents

	<u>Page</u>
Introduction	I
Principles of Tax Equity - Benefits Received and Ability to Pay	4
Equity of Taxation and Public Education	8
Municipal Income Taxes in the U. S. - An Overview	12
Crucial Issues to be Resolved Prior to the Imposition of a Local Income Tax	23
Taxing Jurisdiction	23
Tax Base Composition - The Commuter Tax	25
Tax Base Composition - Personal Income Components	27
Tax Base Composition - Business and Corporate Income	28
Tax Rate	36
Distribution and Impact of Proceeds	40
Real Property vs. Income Taxation	46
Summary and Conclusion	52

INTRODUCTION

"The local income tax as it has developed in this country is an interesting example of inevitability."

Mabel Walker

The number of fiscal experts expressing themselves in favor of municipal income taxes is legion. And it is still growing. The call for municipal income taxes arose in response to (1) an urgent need for additional revenues for local governments, and (2) the need for reforming and restructuring an inequitable and destructive revenue system.

Little needs to be said about local governments' requirements for additional revenues. The concentration of the major socio-economic problems of the American people in our metropolitan complexes is too well known to require much elaboration. These problems recognized by symptoms such as poverty, inadequate housing and deficient education are increasing as a result of national currents and the mobility of our population. Efforts to reduce or eliminate these problems not only require leadership, planning and innovation, but also large sums of money. A more recent phenomenon, the public's concern with their environment, is inevitably leading to immense outlays of funds as well. The heavy near and intermediate term costs of efforts designed to improve and restore our quality of life, of course, will be more than offset by the long-term savings, tangible and intangible, enjoyed by the people in the future. Nevertheless, the need for funds is here and now and it is great and pressing.

Many of the things that need doing here and now by government have statewide and nationwide implications but the state and federal governments have largely abdicated their responsibility for massive fiscal support for the attack on such problems. Thus, it falls upon the localities themselves to increase their budgets to wage battle against the urban-suburban ills with which we are afflicted. Yet the present revenue structure is so inadequate and defective that attempts to raise additional funds encounter increasingly numerous and serious obstacles. These obstacles, of course, are unhappy and rebellious local taxpayers who have been defeating school budgets and bond issues with unprecedented success and whose concerted action is likely to endanger or snuff out many a budding political career. The unhappiness, exhibited by the taxpayers has its roots in a number of causes. On the surface it is the very fact that taxes are rising which appears to contribute most to this unhappiness.

The real blame for the taxpayers' disenchantment must be placed on the weaknesses and shortcomings of the mainstay of our local governmental revenue system, the real property tax. Its inability to increase its contribution in accordance with economic growth necessitates almost perennial highly visible tax rate increases; its regressive incidence places unfairly high burdens on those least able to pay, and its generally poor administration often tends to compound the inherent inequities of the tax. Other negative characteristics of the property tax less clearly perceived by the taxpayers, but even more significant than those cited before, are its distorting effects on land use and its adverse impact on housing.

There exists a clearly and amply documented need for an alternative to the property tax. The recognition of this need has led in many jurisdictions to the imposition of a tax on consumption, the sales tax. In New York State's metropolitan communities, however, the rising needs for local revenues have long ago outstripped the yield potential of the relatively productive sales tax. Its limitation as a local tax to three percent and its detrimental economic and incidence features disqualify this revenue source as the optimal alternative to the property tax. The following analysis attempts to demonstrate that the optimal alternative to the property tax is a municipal income tax.

Following an introductory discussion of the concept of equity of taxation in terms of the "benefit received" and "ability to pay" principles, the discussion will explore the relevance of these principles to the financing of public education. A summary description of the municipal income tax will familiarize the reader with its history, its characteristics and its probable future and will set the stage for a more detailed discussion of several crucial issues which must be resolved prior to the imposition of a local income tax in this community.

Principles of Tax Equity - Benefits Received
and Ability to Pay

The basic rule of equity in taxation is the principle of equal treatment of equals. This principle, derived from the equality of individuals before the law, applies to all types of taxation since all taxes are ultimately paid by individuals. Even taxes on corporations are really taxes on individuals for, in the long run, corporations are simply intermediaries for collecting revenues from consumers, owners or employees.

The principle of equal treatment of equals, however, is an objective which probably can never be fully attained. The major impediment blocking its realization is the limited existing knowledge about tax shifting and therefore about the ultimate impact of many taxes. As long as we don't know the precise ultimate tax burden shouldered by each individual we have no way of measuring and evaluating this rule of equity. Yet, recognition of this impediment does not invalidate the principle but rather leads to the conclusion that over-reliance on taxes whose ultimate burden is difficult to trace is highly questionable from the standpoint of equity.

Equality of treatment of equals can be interpreted in two ways:

(1) equal taxation of those receiving benefits on the basis of benefits received and (2) equal taxation of those with equal ability or capacity to pay taxes.

Under the benefit principle, equity is generally interpreted as that allocation of the burden of taxation which corresponds as precisely as possible to the distribution of public goods and services among the taxpayers. In effect, it means that public goods and services should be paid for by their

consumers. The benefit principle is generally used to justify the real property tax, at least insofar as this tax is used to finance services directly related to the ownership and occupancy of real property. It also represents the basis for special assessments against real property.

Many local government services, however, simply cannot be financed on a benefit basis and this for two primary reasons: (1) service spillovers across the boundaries of existing taxing jurisdictions and (2) the inability to pay on the part of service beneficiaries.

To permit equal and equitable taxation for services the benefits of which spill across the boundaries of taxing jurisdictions, it would be necessary to expand such jurisdictions to encompass the entire benefit area which may be a metropolitan community, a state or even the nation.

Regardless of the size of the benefit area of any given governmental service the cost-benefit principle of taxation cannot and should not be applied to the financing of services which benefit citizens who are unable to pay all or even parts of the service costs. The two most prominent examples of these types of services are public education and social welfare. It is obviously impossible to raise the full cost of social services from the welfare recipients. Similarly, our national policy of universal use of public education would fall far short of its objectives were the cost of public education charged against the direct beneficiaries of the service. These costs must be financed through taxation pursuant to the principle of ability to pay. The chief problem with this principle is neither its rationale nor its acceptability but rather the issue of what constitutes ability to pay.

In most of sixteenth century Europe and later in North America, real estate ownership was designated as the best indicator of a taxpayer's wealth and consequently of his ability to pay taxes. Unfortunately, this designation is still in effect for the financing of local governmental services in the United States; unfortunately, because wealth and ability to pay, today, consist only incidentally of real estate holdings. Over the course of the past century, income has become regarded as the best index of taxpaying capacity. The income measure is superior to the measures of wealth and consumption because income is a more comprehensive index than the other two, comprising both consumption and saving, the latter representing increases in wealth over a period of time.

"Many . . . families enjoy relatively high incomes and consequently high living standards, and yet possess relatively little wealth. On the other hand, there are many others, especially older persons owning homes, businesses or farms, who may possess considerable amounts of wealth but relatively little income and a very modest standard of living."¹

The taxation of wealth is nonetheless necessary and is applied in most countries when increases in the value of assets are realized through sale, via a capital gains tax, or when wealth changes hands through gifts or death, by gift and death taxes.

While there are some who would insist upon the application of only one or the other of the two equity principles discussed, benefit and ability

¹The Ontario Committee on Taxation, Report 1967, Vol I., p. 12.

to pay, most fiscal authorities agree on the merits of each principle. In general, taxes based on benefits are desirable when benefits and beneficiaries of government expenditure programs can be identified relatively clearly, when a modified distribution of wealth and income is not a policy objective and when the imposition of benefit related charges will not result in an inefficient use of that service. On the other hand, ability to pay taxation is appropriate for financing that great portion of governmental expenditures where it is either impossible or inappropriate to allocate costs among taxpayers in accordance with benefits received.¹

And general agreement exists also on the use of fees, user charges and benefit real property assessments to tax according to the benefit principle, and on the income tax as the source of revenue most reflective of a taxpayer's capacity to pay.

¹The Ontario Committee, op. cit., p. 11.

Equity of Taxation and Public Education

As touched on in the preceding discussion, the benefits of certain local governmental services are so diffused as to defy measurements and allocation with any degree of precision. This observation applies in particular to public education. The immediate benefit of public education is for the child being educated and his family. Over time, however, this benefit will be dispersed throughout the nation, a result of our high degree of mobility. Indeed, on the basis of a detailed migration data analysis, B. Weisbrod of Princeton concludes that the mobility of the U.S. population is such that the vast majority of financial returns from public elementary and secondary schooling are generally realized outside the school districts which provide the child's education.¹ The nation at large benefits from public education in still other ways. There exist long recognized relationships between education on the one hand and a well functioning political system, the quality of life, technological advances and minimization of the numbers and social costs of ineffectual and frustrated people on the other.² The logical jurisdiction to provide for the financing of education could consequently be the United States but there are persuasive arguments against such a proposal ranging from the unwieldiness of a federal educational bureaucracy to the restrictiveness of nationwide standards and regulations. Thus, the federal role should logically be confined primarily to the coordination, equalization, and stimulation of the public education efforts of the states.

¹Burton A. Weisbrod, External Benefits of Public Education, Princeton University, 1964, p. 62.

²G. F. Break, Intergovernmental Fiscal Relations in the United States, The Brookings Institution, 1967, p. 63.

Article XI, Section 1 of the Constitution of the State of New York mandates that: "The legislature shall provide for the maintenance and support of a system of free common schools, wherein all the children of the state may be educated."

Since public education is a state function,¹ it would appear no more than reasonable that the state provide for the lion's share of public education outlays. But it doesn't.

For the 18 school districts of Monroe County, total 1970-71 state aid accounted for a mere 42.5% of their budgeted revenues. An increase in state aid to fifty percent of the 1970-71 budgets would have meant 16.7% lower property taxes, an increase to 66.7% or two-thirds of the costs of public education would have permitted a cut in property taxes of more than 50 percent.

"There is an almost irresistible temptation in such matters as school finance to play a game of numbers. We do not pretend that we can justify a magic percentage point--say 56, 59, 61, 64--to which the level of aid should be carried, or beyond which it should not be extended. But we can state that ... school grants can and should exceed half the cost of education."²

The case for the full assumption of the costs of public education by the state has been made repeatedly by a number of experts. One of the more recent treatises on this subject was authored by Professor Raymond of Pratt

¹"Public education is a state and not a municipal function", Buck v. State, 1950, 198 Misc. 575, 96 N.Y.S. 2d 667.

²The Ontario Committee on Taxation, op. cit., p. 408.

Institute.¹ Raymond maintains that while there is no argument with the proposition that the educational program in each school system should be decided by that level of government which is closest to the provision of service and which is most closely attuned to the needs of its users, i.e., the local board of education, the fiscal responsibility for the programs should rest with the state.

Full assumption of costs, however, must inevitably lead to full assumption of program control by the state. For who could foot the bill if all districts in the state chose to adopt the program of, say, a Brighton school district! A much more acceptable proposition is that calling for state assumption of the costs of a standard educational program combined with local options of additional local taxation to supplement the standard program. But even such a proposal would be opposed by those who maintain that in order to secure responsibility in government spending, a significant portion of the costs of public education should be raised on the local level.

In view of New York State's present and future budget problems, it appears more than likely that a significant portion of the costs of public education will continue to be raised at the local level, theoretical and practical arguments to the contrary notwithstanding. The task to establish equity of taxation for public education will, therefore, largely be the responsibility of local government. That equity is lacking needs little additional proof and reiteration. Almost eighty percent of local revenues going towards the support of public elementary and secondary education in Monroe County are

¹George M. Raymond, Relieving Real Estate of School Tax Burdens in New York State, 1970.

raised via the real property tax. And the value of real property bears neither a relationship to benefits received from education nor one to ability to pay on the part of the owner. Moreover, the distorting effects of the property tax on land use are creating huge social and monetary costs and even larger outlays will have to be faced when revised governmental priorities will ultimately call for remedial and corrective action.

Among the alternatives to the property tax are only two types of taxes with significant yields, taxes on consumption and taxes on income. A general sales tax, the most prominent and widely used tax on consumption, is already being levied locally within Monroe County. Moreover, the tax has been repeatedly proven to be regressive and therefore does not satisfy the traditional ability-to-pay principle in regard to the financing of public education. This leaves the tax on income, a good reflection of an individual's ability to pay and in some measure, perhaps even in large measure, the result of educational benefits received.

MUNICIPAL INCOME TAXES IN THE U.S. - AN OVERVIEW

As of 1970, more than 3,500 local governments in the U.S.A. imposed income taxes. With the exception of Bernalillo County (Albuquerque), New Mexico, the local income tax has so far been confined to the eastern half of the United States. In fact, 3,458 of the local jurisdictions levying income taxes are located in two states, Ohio and Pennsylvania.

The Philadelphia tax first imposed in 1939 is the oldest income tax still in existence. By 1960, twenty-three municipalities with populations over 50,000 had adopted and imposed local income taxes. The decade of the sixties experienced a sharp acceleration of this trend towards the municipal income tax: twenty-six large municipalities joined the fold, eighteen of them doing so in 1966 or later. The tax is presently under consideration in major cities such as Atlanta, Boston, Chicago, Dallas, Fort Worth, Minneapolis and San Francisco.¹

Municipal income taxes are currently levied by counties, cities, villages, and school districts. A listing of the larger jurisdictions imposing local income taxes is shown in Table 1.

The chief reasons for the adoption of local income taxes have consistently been fiscal stringency and rapidly rising property tax loads. When it imposed its levy in 1939, Philadelphia had exceeded its constitutional debt limit by forty million dollars and was burdened with real estate delinquencies of nearly twenty-five million dollars. Similarly, severe financial disasters prompted the enactment of income taxes in Cincinnati, Pittsburgh, St. Louis,

¹Advisory Commission on Inter Governmental Relations (ACIR), The Commuter and the Municipal Income Tax, April, 1970, p. 3.

Table 1
LOCAL INCOME TAXES AND RATES BY STATE^a

As of September 1, 1970

State and Locality	Rate (percent)	State and Locality	Rate (percent)
Alabama		Ohio--continued	
Gadsden.....	2.0	Hamilton.....	1.5
Delaware		Kettering.....	1.0
Wilmington.....	.25 or .5 ^b	Lakewood.....	1.0
Kentucky		Lima.....	1.0
Covington.....	2.0	Lorain.....	1.0
Lexington.....	1.5	Parma.....	1.0
Louisville.....	1.25 ^c	Springfield.....	1.5
22 cities under 50,000...	.5-2.0	Toldeo.....	1.5
2 counties.....	.5-1.75	Warren.....	1.0
Maryland	(% of state tax)	Youngstown.....	1.5
Baltimore.....	50.0	267 cities and villages	
23 counties.....	20.0-50.0	under 50,000.....	.25-1.5
Michigan		Pennsylvania ^f	
Detroit.....	2.0	Albington Township.....	1.0
Flint.....	1.0	Allentown.....	1.0
Grand Rapids.....	1.0	Altoona.....	1.0
Lansing.....	1.0	Bethlehem.....	1.0
Pontiac.....	1.0	Chester.....	1.0
Saginaw.....	1.0	Erie.....	1.0
7 cities under 50,000....	1.0	Harrisburg.....	1.0
Missouri		Johnstown.....	1.0
Kansas City.....	.5	Lancaster.....	.5
St. Louis.....	1.0	Penn Hills Township.....	1.0
New York		Philadelphia.....	3.0
New York City	.4-2.0 ^d	Pittsburgh.....	1.0
Ohio		Reading.....	1.0
Akron.....	1.3 ^e	Scranton.....	1.0
Canton.....	1.5	Wilkes Barre.....	1.0
Cincinnati.....	1.7	York.....	1.0
Cleveland.....	1.0	Approx. 3,000 other local	
Cleveland Heights.....	1.0	jurisdictions.....	.25-1.0
Columbus.....	1.0	District of Columbia	
Dayton.....	1.0	Washington.....	2.0-10.0 ^{dg}
Euclid.....	1.0		

^aRates shown separately for cities with 1960 population of 50,000 or more. Where rates differ for resident and nonresident income, only rates on residents are given. In Kentucky, Ohio, and Pennsylvania cities, rates are the same; the nonresident rate is markedly lower in New York City and is half the resident rate in most Michigan cities.

LOCAL INCOME TAXES AND RATES BY STATE^a
(Continued)

^bThe tax is not graduated. If taxable income is below \$4,000, there is no tax; if between \$4,000 and \$6,000, the tax is 0.25%; if over \$6,000, tax is 0.5% of total taxable income.

^cA taxpayer subject to the 1.25% tax imposed by the city of Louisville may credit this tax against the 1.75% levied by Jefferson County.

^dNew York City and Washington, D.C. resident income tax rates are progressive. New York rates range from 0.4% on taxable income of less than \$1,000 to \$380 plus 2% of excess over \$30,000. Washington rates range from 2% on taxable income less than \$1,000 to \$1,770 plus 10% of excess over \$25,000.

^eRate will be raised to 1.4% during 1971 and to 1.5% during 1972 and thereafter.

^fExcept for Philadelphia, Pittsburgh, and Scranton, the total rate payable by any taxpayer is limited to 1%. When other local government units such as school districts levy income taxes, the tax is usually divided equally between jurisdictions.

^gMost authorities consider the Washington, D.C. income tax the equivalent of a state income tax rather than a local tax.

Source: Tax Foundation, Inc., Facts and Figures on Government Finance, 1971, p.240.

and Detroit. Equally important was the steady rise of property tax rates, reaching and exceeding the limits of taxpayer toleration. The promise of property tax reductions was a crucial element in the "selling" of municipal income taxes in such cities as Flint, Saginaw and Grand Rapids, Michigan, as well as Toledo, Ohio. As will be shown at a later stage, pressures on the property tax were, in fact, reduced substantially as a result of the imposition of local income taxes.

The evolution of the local income tax can be sketched very briefly. Beginning in 1939 and continuing until 1962, all municipal income taxes were applied at flat rates, with no personal deductions or exemptions, to earnings derived from salaries, wages and similar sources but not to income from interest, dividends and capital gains. With the exception of Pennsylvania, most cities also taxed net business profits.

The first major change into this relatively simple pattern was introduced in 1962 by the city of Detroit, which allowed a personal exemption of \$600 for the taxpayer and each dependent and brought under the tax all forms of income including interest, dividends and capital gains. The Detroit method was subsequently standardized as the 1964 Michigan Uniform City Income Tax Act, to which all Michigan cities levying the tax now conform.

The most recent change in the existing local income tax pattern was introduced by New York City in 1966. Resembling the federal income tax, the New York City income tax had four distinctive characteristics: (1) like the Michigan cities, New York permits exemptions and makes all types of income subject to taxation; (2) in contrast to all other municipalities, New York

allows residents to deduct personal expenses under rules similar to federal provisions; (3) rather than using a flat rate which previously characterized municipal income taxes, New York applies a graduated rate, ranging from .4 percent on the first \$1,000 of taxable income up to a marginal rate of 2.0 percent on taxable income over \$30,000; (4) New York also grants a small concession to married taxpayers by allowing them to file separately and to divide their joint itemized deductions between the two returns as they see fit.

Most jurisdictions, particularly the cities, tax the income earned by non-residents within the jurisdictions. Generally the rates of this non-resident or commuter tax are identical to those levied on residents but provisions for tax credits often lower the effective rates. The Michigan cities and Baltimore set their commuter rates at one-half the resident rate, a small Pennsylvania town set it at twice the resident rate.¹

The New York City income tax system uses an entirely original approach to the taxation of non-resident income. While residents pay a graduated tax rate on income reduced by deductions and exemptions, non-residents pay a flat rate on income reduced by a sliding scale of exclusions. The net result of New York's fairly complex system is that the non-resident's tax liability as a percent of a single resident's liability runs from trivial percentages for low income levels up to a rare maximum of forty-two percent, with an average of about twenty to twenty-five percent. The non-resident's tax liability compared

¹Elizabeth Deran, An Overview of the Municipal Income Tax, in Municipal Income Taxes, Proceedings of the Academy of Political Science, 1968, p. 22.

to that of the married resident is relatively high, however, in the lower income ranges these resident and non-resident tax liabilities are almost identical.¹

Interestingly, none of the school districts in Pennsylvania are permitted to tax non-residents. Similarly, the two Kentucky counties, Marshall and Jefferson, levying income taxes for school purposes may not tax non-residents.

Most of the cities tax unincorporated firms. Where firms as such are exempted, the tax is generally levied upon the proprietors as individuals. Corporations are not taxed in Pennsylvania municipalities (because of constitutional restrictions) but, with only a few exceptions are included in the income tax base of all other municipalities. Table 2 shows a summary of municipal income tax bases as of 1964.

There is every indication that municipal income taxes in whichever form they are being levied, have performed as well as or better than expected. Their yields are substantial making them the most significant revenue source in a number of jurisdictions. In Canton, Columbus, Springfield, and Youngstown, Ohio, more than 70 percent of all municipal revenues are raised from local income taxes. Table 3 shows the productivity of the income tax in major cities of the U.S. Corresponding figures for the Maryland, Kentucky and New Mexico counties were unfortunately not readily available.

¹Ibid.

Table 2

Municipal Income Tax Bases, January 1, 1964

State	Individuals			Unincorporated business			Corporations	
	Salaries and wages and other compensation for personal services			Net profits			Net profits from activities conducted within city allocated on basis of—	
	Residents		Non-residents	Residents		Non-residents	(1) Property (2) Gross receipts (3) Pay-rolls	(1) Gross receipts (2) Pay-rolls
	Income earned within city	All earned income regardless of origin ¹	Income earned within city	Activities conducted within city	Activities wherever conducted	Activities conducted within city		
Alabama: Gadsden ²	X.....		X.....	X.....		X.....		
Kentucky: ²								
7 cities and 1 county ³	X.....		X.....	X.....		X.....		X
6 cities ⁴	X.....		X.....					
Michigan: 3 cities ⁵		X.....	X.....		X.....	X.....	X.....	
Missouri: St. Louis and Kansas City		X.....	X.....		X.....	X.....	X.....	
Ohio cities		X.....	X.....		X.....	X.....	X ⁶	
Pennsylvania local governments		X.....	X ⁷		X.....	X ⁷		

¹ Various types of intergovernmental tax crediting or reciprocity arrangements are employed in Ohio and Pennsylvania, to avoid double taxation.

² The taxes in Gadsden, Alabama, and in Kentucky cities are imposed as occupational license taxes.

³ Cattlesburg, Frankfort, Lexington, Louisville, Owensboro, Pikesville, Princeton, and Jefferson County.

⁴ Covington, Hopkinsville, Mayfield, Maysville, Paducah, and Newport. In most of these cities businesses and professions are taxed under a separate business license tax.

⁵ Detroit, Flint, and Hamtramck.

⁶ Dayton substitutes for the payroll factor total production costs.

⁷ School districts in Pennsylvania are not allowed to tax nonresidents.

Source: ACIR, Tax Overlapping in the United States, 1964, p. 136.

Table 3

CITY INCOME TAXES, RATES AND COLLECTIONS
(Dollar amounts in thousands)

State and City	Rate 12/31/69 (percent)	Municipal tax collections, 1967-68 Total tax collections	Income tax collections	
			Amount	As % of total collections
Alabama:				
Gadsden	2.0	\$ 4,420	\$ 2,548	57.6
Delaware:	1/4 of 1%			
Wilmington	or 1/2 of 1% ¹	11,778 ²	3	3
Kentucky:				
Covington	2.0	3,326	1,225	36.8
Lexington	1.5	8,939	4,292	48.0
Louisville ⁴	1.25	31,248	16,428	52.6
Maryland:	% of State tax			
Baltimore City	50%	176,886	30,211	17.1
Michigan:				
Detroit	5 6	165,600	47,377	28.6
Flint	5	16,681	8,764	52.5
Grand Rapids	5	13,082	4,243	32.4
Lansing	5	8,243	3	3
Pontiac	5	6,053	3	3
Saginaw	5	6,693	3,367	50.3
Missouri:				
Kansas City	0.5	45,345	11,531	25.4
St. Louis	1.0	89,326	30,351	34.0
New York:				
New York City	1.4-2.0 ⁷	2,680,466	430,191	16.0
Ohio:				
Akron	1.0	21,723	11,138	51.3
Canton	1.4 ⁸	5,944	4,459	75.0
Cincinnati	1.0	48,293	20,365	42.2
Cleveland	1.0	68,447	9,676	14.1
Cleveland Heights	1.0	3,546	3	3
Columbus	1.0	25,467	18,282	71.8
Dayton	1.0	25,227	14,751	58.5
Euclid	1.0	5,438	913	16.8
Hamilton	1.0	3,380	2,034	60.2
Kettering	1.0	2,245	3	3
Lakewood	1.0	3,358	3	3
Lima	1.0	2,418	1,613	66.7
Lorain	1.0	3,166	3	3
Parma	1.0	4,120	3	3
Springfield	1.0	4,154	2,966	71.4
Toledo	1.5	25,987	17,043	65.6
Warren	1.0	3,194	2,182	68.3
Youngstown	1.5	10,235	7,236	70.7

Table 3

CITY INCOME TAXES, RATES AND COLLECTIONS
(Dollar amounts in thousands)
(Continued)

State and City	Rate 12/31/69 (percent)	Municipal tax collections, 1967-68		
		Total tax collections	Income tax collections	
			Amount	As % of total collections
Pennsylvania: ⁹				
Abington Township	1.0 ¹⁰	2,499	3	3
Allentown	1.0 ¹⁰	5,685	1,044	18.4
Altoona	1.0 ¹¹	2,684	1,483	55.3
Bethlehem	1.0 ¹⁰	4,326	541	12.5
Chester	1.0 ¹²	3,289	1,611	49.0
Erie	1.0 ¹⁰	8,010	1,593	19.9
Harrisburg	1.0 ¹⁰	4,411	935	21.2
Johnstown	1.0 ¹¹	2,259	412	18.2
Lancaster	0.5 ¹³	2,222	596	26.8
Penn Hill Township	1.0 ¹¹	1,763	652	37.0
Philadelphia	3.0 ¹²	265,016	126,247	47.6
Pittsburgh	1.0 ¹⁰	55,374	11,237	20.3
Reading	1.0 ¹²	4,858	3	3
Scranton	1.0 ¹⁰ 14	5,113	1,048	20.5
Wilkes Barre	0.5 ¹⁰	3,325	1,195	35.9
York	1.0 ¹⁰	2,286	523	22.9

Note: Includes only cities with 50,000 or more inhabitants in 1960. Excludes Washington D.C., which has a graduated net income tax that is more closely akin to a State tax than to the municipal income taxes. Also excludes the Denver Employee Occupational Privilege Tax of \$2 per employee per month, which applies only to employees earning at least \$250 per month.

¹If total annual wages or net profits are \$4,000 or less, there is no tax liability. On income between \$4,000.01 and \$6,000.00 the rate is 1/4 of 1%; on income of \$6,000.01 or more 1/2 of 1%. The tax rates apply to total income, not merely to the proportion of income falling within a given bracket. In this sense the tax is not a typical graduated levy.

²Fiscal year 1967 collections.

³Tax went into effect after reporting period.

⁴A taxpayer subject to the 1.25 percent tax imposed by the City of Louisville may credit this tax against the 1.25 percent levied by Jefferson County.

⁵Under the Michigan "Uniform City Income Tax Act," the prescribed rates are 1.0 percent for residents and 0.5 percent for nonresidents. A resident is allowed credit for taxes paid to another city as a nonresident.

Table 3

CITY INCOME TAXES, RATES AND COLLECTIONS
(Continued)

- ⁶The rate for residents in Detroit is increased from 1 percent to 2 percent from October 1, 1968 to December 31, 1970.
- ⁷New York City residents' rate ranges from 0.4 percent on taxable income of less than \$1,000 to 2.0 percent on taxable income in excess of \$30,000. An earnings tax of 0.25 percent of wages or 3/8 of 1 percent on net earnings from self-employment, not to exceed that which would be due if taxpayer were a resident, is levied against nonresidents.
- ⁸The Canton rate is 1.4 percent from January 1, through December 31, 1969; and 1.5 percent thereafter.
- ⁹Except for Philadelphia, Pittsburgh, and Scranton, the total rate payable by any taxpayer is limited to 1 percent. For coterminous jurisdictions such as borough and borough school district, the maximum is usually divided equally between the jurisdictions unless otherwise agreed. However, school districts may tax only residents. Thus, if a borough and a coterminous school district each have a stated rate of 1 percent, the total effective rate for residents is 1 percent (1/2 of 1 percent each to the borough and school district) and the tax on nonresidents is 1 percent, the stated rate imposed by the borough.
- ¹⁰The school district rate is the same as the municipal rate.
- ¹¹The school district rate is 0.5 percent.
- ¹²There is no school district income tax.
- ¹³The school district rate is 1.0 percent.
- ¹⁴Combined city and school district rate may not exceed 2.0 percent.

Source: ACIR, The Commuter and the Municipal Income Tax, Washington, 1970.

Most local income taxes now in effect are imposed in large cities. However, indications are that the future of the local income tax will parallel the widespread use of local sales taxes which in several states are virtually universally used supplements to the state sales taxes collected by the state. The best example of this type of income tax is the local income tax supplement mandated by the State of Maryland for its counties; each county and the City of Baltimore levy a separate rate as a percentage of the state income tax from a mandatory twenty percent minimum to a fifty percent maximum of the state tax. Another example of a local tax supplement to the state tax is Bernalillo County, New Mexico.

As state income tax supplements, local income taxes will have the general character of a state tax and, therefore, if universally applied throughout a state, will have no impact on the intrastate location of economic activity. They may be thought of as substitutes for outright state aid with the distribution of funds based on the origin of the tax collections rather than on formulas which attempt to compensate for interjurisdictional differences in need and ability to pay.¹

If not universally applied but confined exclusively or primarily to personal rather than business and corporate income, the tax may actually make the jurisdictions imposing such taxes more attractive to business and industry.

¹Dick Netzer, Impact of the Property Tax - Its Economic Implications for Urban Problems, May, 1968, p. 41.

SOME CRUCIAL ISSUES TO BE RESOLVED PRIOR TO THE IMPOSITION OF A LOCAL INCOME TAX

As has been pointed out in the preceding section local income taxes today come in a variety of shapes and patterns, and it is quite difficult therefore to make recommendations for an income tax for the Rochester area without first discussing and evaluating the more significant aspects in which existing local income taxes differ from each other. Chief among these aspects are (1) the definition of the taxing jurisdiction, (2) the determination of the tax base, (3) the determination of the tax rate, and (4) the allocation of the tax proceeds.

The Taxing Jurisdiction

Since the primary objective of levying an income tax is to provide a more sensible and equitable revenue base for the financing of public education; since the most sensible and equitable jurisdiction for school financing is a county or a region;¹ and since the largest jurisdiction below the state level empowered to levy taxes is the county, it would be futile to argue in favor of a taxing jurisdiction other than the county.

¹ See: ACIR, Fiscal Balance in the American Federal System, Vol. II, Metropolitan Fiscal Disparities, p. 9 "most observers of today's urban America agree that inadequate and deteriorating education is a paramount problem in the central city ghetto. To halt and reverse this process we must begin financing our schools from a tax base broader than that of the individual political jurisdiction. State aid can and should be increased and equalization features improved; Federal aid should and no doubt will be increased. However, if the future of the American federal system of government is to be preserved, our metropolitan communities, which are becoming increasingly interdependent economically, must adjust to more of an areawide approach to the financing of public services, especially education"

An apparent problem with this approach is the fact that the boundaries of school districts headquartered in Monroe County do not conform to the boundaries of the county. A countywide tax levy, therefore, would tax some Monroe County residents who live in school districts headquartered outside of Monroe County, while it would fail to tax the residents of those portions of Monroe County school districts which extend beyond the county boundary. This complication should not be used to advance the cause of a different taxing jurisdiction because other municipalities and combinations of municipalities are afflicted with the same kind of school district boundary meandering as are individual counties. The need here is for a set of administrative arrangements which would reduce these complications without harming the overall objectives of the countywide tax program. Ideally, of course, school district boundaries should be straightened to eliminate the existing overlaps. In a number of instances, however, the overlaps are too sizeable¹ to permit any immediate expectations of making Monroe County school districts coterminous with Monroe County.

If all or part of the proceeds of a countywide income tax are to be used to (1) finance central educational services, and (2) reduce present property tax rates, the arrangements with overlapping districts could be roughly as follows:

- A. For Monroe County school districts extending beyond Monroe County (e.g. Honeoye Falls-Lima)

¹ Particularly the Kendall and Caledonia-Mumford district portions within Monroe County and the Honeoye Falls-Lima portion outside Monroe County.

1. All children regardless of residence would be eligible for Monroe County central services, but, the central services costs allocable to children living outside of Monroe County would be financed via a BOCES-type charge-back upon the property tax; and
 2. The countywide tax proceeds may be used for property tax reductions only within the Monroe County portion of the overlapping school district.
- B. For school districts headquartered outside of Monroe County but reaching into Monroe County (e.g. Caledonia-Mumford).
1. The school district could be permitted to join the Monroe County system under the same conditions as set forth under A; or
 2. None of the districts' children, regardless of residence, are eligible for central services financed by Monroe County levy, but,
 3. Monroe County taxpayers in these districts would receive property tax reductions determined on the basis of their fair share of the total countywide tax yield before allocation is made between costs of central services and amounts to be set aside for tax rate reductions and equalization.

Tax Base Composition - The Commuter Tax

As previously indicated, the extension of municipal income taxes to nonresidents is a common feature of municipal levies. Major exceptions are Washington, D. C., five small Pennsylvania cities, and the school districts in

Pennsylvania. Extension of the municipal income tax to nonresidents has considerable revenue implications for central cities receiving large commuter flows. Unfortunately breakdowns of revenue yields between resident and non-resident taxpayers are not generally available. The Cincinnati experience for 1964, when 37 percent of the returns filed and 39 percent of the revenues collected came from nonresidents, gives some indication of the large contribution made by commuters into central cities.

The imposition of a tax on commuters raises a sore point of inter-governmental relations: How can the tax liability of a person living in one area, working in another, and taxable in both, be apportioned fairly between the jurisdictions? Localities justify commuter taxation on the grounds that they are forced to provide additional services as a result of the presence of commuters as well as offering the opportunity for the nonresident to earn an income. So far, efforts to determine the commuter share of city costs have proven to be unsuccessful. George Break¹ of the University of California suggests to price out the costs of serving the commuter by measuring the time spent by him and his family in various jurisdictions. However, he exempts costs of public education from this procedure:

"While public schools . . . do create social benefits which accrue to the taxpayer both where he works and where he lives, the private benefits enjoyed by him and his family will normally be provided only by the government of residence."²

The case for commuter taxation declines as the taxing jurisdiction is enlarged and as more and more of the tax proceeds are allocated for public

¹George F. Break, Intergovernmental Fiscal Relations in the United States, The Brookings Institution, Washington, D.C., 1967, pp. 51-52.

²Ibid.

education. In 1960, the most recent year for which gross commuter statistics have been published, 81,900 residents of the towns of Monroe County and of the five counties contiguous with Monroe County commuted to work in the City of Rochester, equivalent to 65.0 percent of the city's resident employment of 125,986. For Monroe County as a whole, however, the number of in-commuters was only 13,775 equivalent to 6.1 percent of its resident employment of 224,674.¹ In other words, assuming a roughly uniform distribution of taxable income between resident and nonresident workers, a city income tax would rise in yield by 65.0 percent if commuters were taxed at the same rate as resident workers, the yield of a county income tax, on the other hand, would rise only 6.1 percent as a result of taxing nonresident workers. In actual practice these percentages would be probably even lower due to the prevailing practice of taxing nonresidents at only a fraction--generally one-half--of the resident tax rate, and due to the fact that a portion of the income of nonresidents, e.g., dividends, interest, capital gains would not necessarily be subject to taxation by Monroe County.

To the extent that county income tax revenues are to be used for non-education purposes taxation of commuters is desirable and equitable and, while a two or three percent increase in tax yields from commuter taxation may sound small, in absolute dollars two or three percent of twenty million dollars amounts to a very respectable \$400,000 to \$600,000.

Another advantage from commuter taxation would, in the long run, accrue to the region as a whole. Counties seeing their out-commuting residents taxed

¹Source: 1960 U. S. Census of Housing and Population.

by Monroe County will be sorely tempted to reciprocate and levy their own taxes to catch the Monroe County residents commuting to work in their jurisdictions. A simple mutual tax credit arrangement among the counties--similar to that existing among Michigan cities--would restore tax equity. The net result would be lessened reliance on the property tax and more equitable taxation throughout the Region.

Tax Base Composition - Personal Income Components

The early forms of municipal income taxation were essentially payroll taxes, taxes on wages, salaries, commissions and the like. Experts frown on this tax for two major reasons: (1) earned income is not as good a reflection of ability to pay as is aggregate personal income including income derived from interest, dividends, and capital gains, and (2) it is very difficult to make any informed statement about the equity of this tax due to insufficient statistical data and the utter lack of agreement as to who actually pays the tax.¹ Aside from any pros and cons on the issues of payroll versus income taxes, the existing administrative mechanism in New York State for the collection of a comprehensive personal income tax is an excellent reason for deciding on a tax base identical to that covered by the state income tax.

Tax Base Composition - Business and Corporate Income

In theory, the taxation of businesses and corporations, for purposes other than direct services received, has very little justification. Any such

¹ I. J. Goffman and S. V. Sack, Supplementary Financing of Public Education in the Metropolitan Atlantic Region, 1969, p. 21.

tax is ultimately born by the owners of the business or corporation, by the consumers of its products, by its employees, or some combination of these. While economists do not agree on which component bears what proportion of the tax, there is no question that virtually all taxes, except the estate tax, are taxes on the current income of individuals. And the business or corporation is no such individual. "Equity provides no basis for the taxation of corporate income", concluded the Ontario Committee on Taxation in 1967.¹ They reasoned that corporate taxation does not conform to the principle of ability to pay. Ability to pay relates to the burdens borne by real persons in the form of subjective sacrifices incurred in parting with income. In this sense, therefore, corporations have no ability to pay; their ability to pay is that of the individuals who ultimately bear the tax. If the tax is not shifted, it is a tax upon the shareholders and owners and it is not a tax on their ability to pay, but on the profitability of the company. If it is shifted forward to consumers in the form of higher product prices, it is a tax on consumption, highly regressive, since unlike our sales tax, the corporate income tax increases the prices of food, drugs, and other tax exempt necessities. If the tax is shifted backward in the form of lower pay scales, chances are its incidence will be regressive since the relatively high degree of mobility of the professional and high income earner would make it appear highly unlikely that a significant portion can be shifted backward to him. The Ontario Committee concluded quite candidly that the corporate income tax must find its strongest defense on the basis of its yield.

¹The Ontario Committee on Taxation, op. cit., p. 16.

Aside from these considerations of equity or rather, in spite of them, it is important to note that business and industry have fared well under existing local income taxes.¹ They are not taxed at all on the local level in Pennsylvania. Elsewhere, corporations covered have not considered the 1 percent or lower rate as particularly burdensome. As far as could be determined, as of 1965 there were no known cases where any industry has moved out of a local income tax area in protest to the tax.² Annual contributions by corporations have averaged between 6 and 10 percent of total annual income tax yields. In Detroit, corporations in 1963 contributed 10 percent of the total yield. The percentage yield was six percent in Youngstown, 6-1/2 percent in Akron, 10 percent in St. Louis and Dayton.

More recent data from Ohio cities are shown in Table 4. Corporate contributions in 1967 ranged from 6.3 percent in Youngstown to 13.2 percent in Cincinnati. The percentages in column three of Table 4, identified as originating "from other sources" apparently refer to taxes on incomes of individuals whose taxes are not being withheld, on net profits of unincorporated businesses and others. Unfortunately, it is impossible to determine what portion of these percentages are directly attributable to the taxation of the unincorporated business sector.

The crucial question confronting business is: will a broad based income tax cost business more or less in the long run than continued reliance on the property tax to raise municipal funds?

¹Robert A. Sigafoos, The Stake of Business in the Growing Municipal Income Tax Movement, in State and Local Taxes on Business, Tax Institute of America, 1965, p. 119.

²Ibid.

TABLE 4

SOURCE OF INCOME TAX RECEIPTS--1969
EIGHT OHIO CITIES OVER 100,000 POPULATION

<u>City</u>	<u>Percent from Withholding</u>	<u>Percent from Corporations</u>	<u>Percent from other Sources</u>
Akron	81.8	8.0	10.2
Canton	78.3	6.8	14.9
Cincinnati	75.4	13.2	11.4
Cleveland	not available	11.1	not available
Columbus	79.9	8.6	11.5
Dayton	80.3	8.5	11.2
Toledo	76.6	6.6	16.8
Youngstown	81.4	6.3	12.3

Source: J. E. Gotherman, "Municipal Income Taxes", in Municipal Finance, February, 1971, p. 129.

To assist a firm in the evaluation of these alternatives a representative experience in an Ohio city may prove helpful.¹ Dayton collected \$8.1 million from its income tax in 1963. It would have required a property tax rate of \$10.57 per \$1,000 of assessed valuation to produce an equal amount from the property tax. A Dayton corporation with real property assessed at \$1 million and annual net profits of \$250,000 attributable to its Dayton operations paid a local net earnings tax of \$2,500 (1 percent on \$250,000). If the \$8.1 million had been raised via the property tax, the tax burden on the corporation would have been \$10,570 (\$10.57 per \$1,000 of assessed valuation), an amount more than four times as large as its tax obligation under the Dayton income tax.

¹ Robert A. Sigafoos, op. cit., pp. 123-124.

The effects of higher taxes on business and industry have been well publicized in recent months. The protests by the New York State business community against the Governor's increase in business taxes were loud and definite. Several Monroe County corporations vowed to cease expansion in this state and subsequent actions by these corporations proved that these statements were no idle threats. Traditionally, business taxes were given relatively low rankings as factors in the location decisions of industrial concerns. However, with more and more areas throughout the U. S. competing for industry and equalizing the quality of many top ranking location factors, e.g., labor supply, transportation, and utilities, taxes are assuming an increasingly significant role in the location decision process. With other things being approximately equal, taxes could be the "straw that breaks the camel's back". John Due, in a recent publication, stated quite clearly that "a state that has relatively high property tax rates will almost certainly lose fabrication and wholesale distribution activity to nearby states".¹ In a similar vein, a recent survey conducted by the Rochester Center for Governmental and Community Research, Inc.,² revealed that manufacturing enterprises throughout the 8-county region considered taxes one of the four most serious locational deficiencies in the area. Our county may do well to keep in mind Mabel Walker's reminder that "the taxes industry is likely to pay and the expenses it will cause the community are of far less significance than the measure of prosperity it will bring the area".³

¹John F. Due, How Should State and Local Governments Tax Business, Chicago, 1970.

²Friedrich J. Grasberger, Prospects for Manufacturing, Rochester Center for Governmental and Community Research, Inc., 1971.

³Mabel Walker, Fiscal Considerations Involved in Patterns of Industrial Development, Tax Policy, Tax Institute of America, March, 1964.

These considerations must play a crucial role in the legislative decision-making process which will determine whether or not, how, and to what extent business and industry should be taxed to replace revenue losses resulting from a decreased property tax burden. As previously pointed out, business and industry are not subject to local income taxes in Pennsylvania. Where their earnings are taxed locally, the extremely low rates imposed, on the average represent a smaller tax burden than that which would have been required via the property tax.

A recent proposal by Governor William G. Milliken to the Michigan Legislature calls for a surcharge upon the state personal income tax and a value added tax upon business and industry to eliminate property taxes for school operating purposes altogether. The value added tax component is intended to yield enough revenue to match the present school property tax contribution by business and industry and, in addition, permit a reduction in the present corporate franchise tax. While this proposal has been endorsed by the Michigan State Chamber of Commerce¹ preliminary indications are that the business community is deeply divided on the issue and that prospects for implementation are presently very dim.

Representatives of business and industry have repeatedly stated that they are willing to pay their "fair share" of the tax burden. While the protests have been loud, both from business and non-business taxpayers

¹ Michigan State Chamber of Commerce, State Chamber Policy Relating to Michigan Tax Revenues, May 13, 1971.

about the rising level of property taxation, surprisingly few such protests¹ emanate from the business community about its share of the property tax load. By implication, therefore, business in general does not object to the practice of local governments taxing its real property at the same rate as the property of residents. Any part of a local income tax which would be used for property tax rate reduction would, however, redistribute the present share of taxation, lessening the burden on business and industry and increasing the burden on the non-business taxpayer. Since business property assessments presently account for about forty percent of Monroe County's total tax base, business is contributing this same proportion of the total real property tax burden imposed within the county. On the other hand, according to the experiences of communities with local income taxes, corporate taxpayers contribute only about ten percent of the total levy with an additional small portion contributed by unincorporated business. Consequently, for each forty cents of real property tax reductions business' share of a local income tax would probably rise by only a little more than ten cents. By the same token, for each forty cents of property tax increases avoided because of the imposition of a local income tax, business will have to contribute only about ten cents in the form of a local tax on net earnings.²

¹The New York State Board of Equalization and Assessment in its more recent surveys of real estate values and assessment levels notes significant variations in assessment levels between business and non-business properties with non-business properties usually being assessed at higher rates than residential properties. Those business properties which have protested against their assessments are primarily downtown retailers.

²The precise share of business and industry's contribution under a local income tax would have to await the determination of the size of its locally generated net profits.

There are a number of ways of preventing such a redistribution of tax burdens, if this redistribution is deemed to be undesirable. First of all, business has not clearly stated that it would prefer a local income tax as a partial substitute and supplement to the real property tax. If business prefers the property tax, a rather unlikely prospect if precedents elsewhere have any validity, it could be exempted from a local income tax. In this case, it would continue to pay present property tax rates. Should the property tax rate equivalent of property and local income taxes on the non-business sector increase, the property tax on business would have to rise commensurately.

Should business declare itself in favor of an income tax, a second alternative which would avoid a shift in tax burden distribution would be differential income taxation, the imposition of a higher tax rate on net business earnings which, in the aggregate, would produce the equivalent of what a tax on business property would have yielded.¹ This alternative would ensure business' contribution to local tax collection under a property and income tax system to be identical with its contribution under a property tax system alone.

However, the combined property tax - income tax system would result in significant shifts among the business components of the county tax base. Businesses with high profits and low capital intensiveness would pay

¹ See also: S. H. Greenspan and F. J. Grasberger, "Target: The Three E's", Rochester Center for Governmental and Community Research, Inc., p. 102.

higher taxes than at present; inversely, businesses with high investments in land and plant but low net profits would contribute less to total tax collections than under the present property tax system.

The Tax Rate

The consensus of expert opinion appears to be in favor of a flat rate for local income taxes.¹ The flat income tax has made progress against strong opposition. Much of this opposition centers upon the fact that the flat rate tax imposes a burden even upon the poorest, as long as they earn some income. The arguments for the flat rate income tax are that it is the most productive of the local non-property taxes, that it is simple to administer and that it does not appear to have caused migration of business enterprises or upper income residents.

Some of the more recent municipal income tax enactments have provided for a measure of progressivity by permitting the use of deductions, exemptions and in some cases, by providing for explicit graduated rates. Yet, expert opinion still argues against the progressivity feature, without however, being able to cite tangible evidence of its inferiority to a flat tax rate system.²

An acceptable argument against the indiscriminate use of progressivity schedules is the great variety of different kinds of progressivity schedules in effect throughout the U.S. The major examples of a progressive

¹See ACIR, The Commuter and the Municipal Income Tax, op. cit., pp. 7-9. Also see Mabel Walker, The Inevitability of City Income Taxes, op. cit., p. 6.

²ACIR, Ibid., p. 9.

local income tax are the Maryland county income taxes which are surcharges upon the progressive Maryland State income tax. However, the progressivity of the Maryland personal income tax is one of the lowest in the U. S. Its lowest tax bracket, the first \$1,000 of taxable income, carries a rate of 2%, its highest bracket, income over \$3,000, a rate of 5%. Thus, in effect, the Maryland tax becomes a proportional tax of 5% on taxable incomes in excess of \$3,000.

In sharp contrast, New York State's tax rate rises from 2% on the first \$1,000 of taxable income to 14% on income in excess of \$23,000 representing a ratio of 1:7 from the lowest to the highest tax rate. Even the federal tax progression is less than New York State's, rising from 14% on the first \$1,000 of taxable income to 32% for the \$20,000-\$24,000 taxable income bracket representing a ratio of 1:2.3.

New York State has one of the steepest, if not the steepest, tax rate progression schedules in effect in the U. S. Therefore, without a thorough study of the equity or lack of equity of this schedule there exists little justification to recommend a local income tax levied in the form of a straight surcharge upon the New York State schedule. This argument, however, does not invalidate the use of the New York State income tax collection system as the vehicle to collect local income taxes.

There are a number of possible types of "piggy back" arrangements:

- (1) a flat rate against taxable gross income, (2) a flat rate against income after exemptions, (3) a flat rate against net taxable income after exemptions and deductions and (4) percentage surcharges upon the New York

State tax liability. All of these alternatives, except for the first one, contain elements of progression with the last alternative being, in effect, identical to the graduated tax imposed by the state.

A one percent flat rate would have yielded Monroe County for 1970-71:

under alternative (1), approximately \$27,000,000 plus \$3,000,000 from business taxes,¹

under alternative (2), approximately \$23,000,000 plus \$3,000,000 from business taxes,

under alternative (3), approximately \$19,000,000 plus \$3,000,000 from business taxes.

Alternative 4, if it follows the example of the Maryland counties which levy between 20% and 50% of their state tax liability, would yield between \$19,000,000 and \$48,000,000 from personal income taxes plus an undeterminable amount from business taxes. To place these figures in perspective, it should be kept in mind that the 1970-71 real property taxes for public elementary and secondary education in Monroe County amounted to \$94,000,000.

The ultimate choice of the income tax rate or rate structure will undoubtedly have to depend on a combination of considerations including equity, yield and salability of the tax package. The writer's preference is for alternatives 2 or 3 which would exempt the income of the poor and a portion of everyone's income but tax excess income on a proportional rather than a progressive basis. This preference is based on the conviction that ability

¹ Assuming the experience of other jurisdictions is relevant.

to pay does not necessarily grow at a progressive rate above a minimum income level of several thousand dollars. In fact, growing income is frequently accompanied by voluntary and involuntary outlays which are directly connected with or are a result of rising incomes.¹ As shown in Table 5 a proportional tax on incomes in excess of exemptions and deductions does, in fact, contain some degree of progressivity.

TABLE 5

Effective Tax Rates on Gross Income of a 1% Local Income Tax on Taxable Income in Excess of Exemptions and Standard Deductions

Gross Income	Exemptions for 4 Dependents	Standard Deduction	Taxable Income	Yield of a 1% Local Income Tax	
				Amount	% of Gross Income
\$ 5,000	\$2,600	\$ 960	\$ 1,440	\$ 14	.28
7,000	2,600	910	3,490	35	.50
10,000	2,600	1,300	6,100	61	.61
20,000*	2,600	1,500	15,900	159	.80
50,000*	2,600	1,500	45,900	459	.92

*Taxpayers in these tax brackets generally use itemized rather than standard deductions. According to an Analysis of 1967 New York Personal Income Tax Returns, by the New York State Department of Taxation and Finance, itemized deductions for the \$20,000 income family filing jointly accounted for 15.2% of gross income which figure if incorporated into the above tabulation would yield an effective local income tax rate of 0.72%. A corresponding calculation process for the \$50,000 income family itemizing deductions results in an effective local income tax rate of 0.82%.

Source: Department of the Treasury, Internal Revenue Service, 1971 Income Tax Tables and Rates, Publication 713.

¹The popular interpretation that the ability to pay principle requires progressivity of taxation is based on the assumption of declining marginal income utility. Each increment to income is supposed to have less utility than the preceding increment and therefore should make a correspondingly higher tax contribution. The validity of this theory has been criticized for a number of reasons, the most important of which is that "rising needs develop with rising income and a person's marginal income utility is said to shift upward as his income rises". (See R. A. Musgrave, The Theory of Public Finance, 1959, pp. 102-105.)

As previously shown in Table 1, the tax rates imposed by local jurisdictions range from a low of one quarter to one half of one percent in Wilmington, Delaware to a high of three percent in Philadelphia.¹ The vast majority of municipalities, however, levy income taxes at a rate of one percent. Even at this relatively low rate, the tax yields have been substantial. As shown in Table 6 following, the per capita yields of cities imposing one percent income taxes range from \$9.53 in Allentown, Pennsylvania to \$60.55 in Dayton, Ohio. Of course, the figures for cities with large net in-commuting patterns and with commuter taxes show heavily inflated per capita figures. The per capita collections are also a function of (1) whether or not unincorporated and incorporated businesses are taxable, (2) whether the tax is on earned income only or on total income and (3) upon the absolute income and earnings levels and the profitability of business in the taxing community. In any event, the per capita yields of the previously discussed Monroe County income tax alternatives ranging from a low of \$30.90 for alternative three to a high of \$42.13 for alternative one compare favorably with most of the data shown in Table 6.

Distribution and Impact of Proceeds

Before proceeding with the delineation of possible guidelines for the use of the proceeds of a Monroe County income tax, it should be reiterated that local income taxes have served well to reduce municipalities' reliance on the real property tax. After a study of the impact of local

¹The progressive Washington, D. C. rate rising to 10 percent on income in excess of \$25,000 may more properly be considered a state income tax.

Table 6

RATES AND PER CAPITA YIELDS OF INCOME TAXES
IN LARGER CITIES, 1967-68

	<u>Tax Rate</u>	<u>Income Tax Collection Per Capita¹</u>
Gadsden, Ala.	2.0	\$47.25
Covington, Ky.	2.0	23.32
Lexington, Ky.	1.5	39.69
Louisville, Ky.	1.25	45.45
Baltimore, Md.	50% s.c.	33.35
Detroit, Mich.	.5-1.0	31.32
Flint, Mich.	.5-1.0	45.33
Grand Rapids, Mich.	.5-1.0	21.47
Saginaw, Mich.	.5-1.0	36.66
Kansas City, Mo.	.5	22.74
St. Louis, Mo.	1.0	48.78
N.Y.C., N.Y.	.4-2.0	54.68
Akron, Ohio	1.0	40.44
Cincinnati, Ohio	1.0	45.00
Cleveland, Ohio	1.0	12.89
Columbus, Ohio	1.0	33.88
Dayton, Ohio	1.0	60.55
Toledo, Ohio	1.5	44.40
Allentown, Pa.	1.0	9.53
Bethlehem, Pa.	1.0	7.44
Erie, Pa.	1.0	12.33
Philadelphia, Pa.	3.0	64.79
Pittsburgh, Pa.	1.0	21.60
Scranton, Pa.	1.0	10.12

¹ 1967-68 collections related to 1970 population.

Sources: 1. ACIR, Commuters and the Municipal Income Tax
2. 1970 U.S. Census of Population

income taxes, Elizabeth Deran concluded that "while income taxes usually have been introduced under conditions of severe financial stress, with the primary objective the capture of additional revenue, the evidence suggests that in practice the income tax has to some degree acted as a substitutive rather than supplemental source of revenue, and in particular has taken some of the pressure off the property tax".¹

Although the objective of property tax reduction is of vital importance equally important is the attainment of a greater degree of the tax effort equalization. The distribution of local income tax collections of between \$22,000,000 (alternative 3) and \$30,000,000 (alternative 1) back to the school districts would lower the school property tax burden in Monroe County by between 23.4 and 31.9 percent. To place these figures into proper perspective, the comparisons in Table 7 will indicate the approximate break-even point for increased income tax versus decreased property tax payments.

It is apparent from the data shown in Table 7 that whether or not, or to what extent, an individual benefits from the imposition of an income tax depends on the relationship between his taxable income and the value of his home or apartment.² Of course, these relationships change from school district to school district with residents of high tax rate school districts benefiting more than residents of low tax rate districts, if the proceeds are returned on the basis of full valuation.³ On the average, however, the break-

¹Elizabeth Deran, Tax Structure in Cities Using the Income Tax, National Tax Journal, June, 1968, p. 152.

²For apartment dwellers, property tax reductions will materialize only if the landlords are willing to make proportionate rent adjustments.

³The relationships shown in Table 7 will come closest to reality if the funds are used to finance countywide educational services, the costs of which, in the absence of a countywide tax, have to be charged back to individual districts on some average or proportionate basis.

Table 7

AVERAGE IMPACT OF AN INCOME TAX ON MONROE COUNTY RESIDENTS

Income : Home Value Ratio	Income	Home Value ¹	Present School Tax ²	Alternative 1		Alternative 3	
				Prop. Tax Reduction	Income Tax ³	Prop. Tax Reduction	Income Tax ⁴
1 : 1.5	\$ 5,000	\$ 7,500	\$ 150	\$ 47.87	\$ 50.00	\$ 35.11	\$ 32.50
	10,000	15,000	300	95.74	100.00	70.21	64.00
	20,000	30,000	600	191.49	200.00	140.42	150.00
1 : 2	5,000	10,000	200	63.83	50.00	46.81	32.50
	10,000	20,000	400	127.66	100.00	93.62	64.00
	20,000	40,000	800	255.32	200.00	187.23	150.00
1 : 2.5	5,000	12,500	250	79.79	50.00	58.51	32.50
	10,000	25,000	500	159.57	100.00	117.02	64.00
	20,000	50,000	1,000	319.15	200.00	234.04	150.00

¹Taxable full value of a home or apartment²Computed at \$20 per \$1,000 of Full Valuation³1% on gross income

⁴1% on net taxable income which is 65%* of a gross income of \$5,000
 1% on net taxable income which is 64%* of a gross income of \$10,000
 1% on net taxable income which is 75%* of a gross income of \$20,000

*Source: New York State Department of Taxation and Finance, Analysis of 1967 Personal Income Tax Returns.

even point lies in the vicinity of an income : full value ratio of 1.5.¹ As the full value of one's home or apartment--and consequently one's property tax burden--increases in relation to one's income, the property tax reductions effected by the imposition of an income tax increase as well.

These relationships hold even if none of the income tax proceeds are distributed back to the districts. Instead of reducing property taxes by the margins shown, they will prevent increases in property taxes by these same margins.

The direct return of income tax proceeds to school districts on the basis of full valuation would not equalize any of the existing tax differentials among the school districts. A distribution formula providing for equal amounts per pupil provides some equalization of tax burdens because a fixed amount per pupil has a larger impact upon the tax rate of a valuation-poor district than on a wealthy district. This approach is presently being used for the distribution of the town school district's share of the Monroe County sales tax. As demonstrated in Target: The Three E's,² the weakness of this distribution formula is that it fails to establish a relationship between the amount of property tax reduction and the level of local fiscal effort. "The Three E's" emphasized that

"What is needed is a system which recognizes present local effort, equalizes local efforts and provides an incentive to raise the local effort to an adequate or median level.

¹To be precise, the breakeven point for alternative 1 is a 1 : 1.57 ratio, for alternative 3, a 1 : 1.39 ratio.

²Op. cit., pp. 103-104.

An effective approach to obtain such equalization is to use the general state aid formula as the base for a county aid formula."¹

The "Three E's" study illustrates the effects and the effectiveness of such an approach. However, it further suggests that supplemental aid to school districts be computed not on the basis of past expenditure patterns, as is the case under current state aid legislation, but according to proposed and budgeted outlays.²

In fact, if the Fleischman Commission fails to come up with or fails to have adopted some drastic improvements and reforms in the present state aid formula system, the county should use its local income tax proceeds to create such reforms on the local level, at least within Monroe County. It should first of all decide on a realistic operating expenditure ceiling. Secondly, an up-to-date aid ratio should be established for each school district using the current full value per pupil ratio, not that of eons ago. Thirdly, the state-determined weightings for elementary (1) and secondary (1.25) pupils used to arrive at weighted average daily attendance should be reviewed and revised to conform to local conditions. Fourth, weighted enrollment might be an even better measure than weighted average daily attendance. Fifth, the local (Monroe County) average full value per pupil rather than the state average should be used to determine wealth differentials among the school districts. As a result, the school districts' New York State operating aid could be supplemented sufficiently with local income tax proceeds.

¹Ibid., p. 104.

²Ibid.

to eliminate most if not all shortcomings of the state aid system. Similar formula updating and reform efforts should be applied to the building and transportation aid distribution patterns. Each subsequent year's determination of supplemental aid going to the individual school districts would take into account and adjust for the over or under payments made to the school districts in the preceding year due to estimating inaccuracies which are an unavoidable by-product of the use of projected valuation, enrollment and expenditure data.

All these recommendations while representing substantial improvements of the present state aid system, if implemented, do not represent a fundamental change in a system which determines need and ability to pay on the basis of two measures: "bodies" and full valuation of real property. It is hoped that the Fleischman Commission will recommend a considerably more sophisticated and equitable aid system than that now in effect.

Real Property vs. Income Taxation

One of the most concise criticisms of the real property tax is that recently authored by Dick Netzer in Impact of the Property Tax.¹ Netzer distinguishes between INHERENT and REMEDIABLE defects of the real property tax. It is these inherent or fundamental defects which defy remedy and which mandate the selection of better and more suitable alternatives. Among the major inherent shortcomings of the property tax are:

¹Dick Netzer, Impact of the Property Tax, Effect on Housing, Urban Land Use, Local Governmental Finance, prepared for the consideration of the National Commission on Urban Problems, Washington, D. C., 1968.

1. Its adverse effects on a community's housing stock;
2. The regressivity of housing taxes among tenants and among home owners;
3. The lack of neutrality among types of economic activity; and
4. Its effect of pushing farmers out of urbanized areas.

The real property tax amounts to a very high consumption tax on housing expenditures. The effective sales tax equivalent for a middle income home owner in Monroe County lies between forty and fifty percent of total housing expenditures.¹ This excessive level dampens the effective demand for housing and consequently limits growth in a community's housing stock. Moreover, the well known disincentive effect of the real property tax on home improvements and beautification must bear some responsibility for the deteriorating quality of our existing housing stock. An income tax does not have any specific adverse effects on housing.

Another serious defect of the property tax is its regressivity, its relatively heavy burden on low income earners.² Virtually all income taxes presently in existence escape this charge. Personal income taxes are very progressive in jurisdictions with graduated rates and mildly progressive where the rates are flat charges against income exclusive of exemptions or deductions. Even the straight flat rate is proportional rather than

¹F. J. Grasberger, A Critical Review of the Property Tax System, an address to the Rochester Chamber of Commerce, 1971.

²In fact, residential property tax payments decline sharply as a percentage of average income as income rises but rise again for the middle income classes. For the income class over \$15,000, the percentage again drops. (Netzer, op. cit., p. 42).

regressive. Local income taxes on business, assuming that the tax is shifted forward to the consumer, are moderately regressive--their effect being similar to that of a sales tax. If the tax is not shifted and borne by the stockholders, it may very well be progressive if most stocks are held by high income earners.

A third fundamental defect of the property tax is its lack of neutrality among those types of business activities which do or do not require heavy investments in real property. Cases in point are utilities and firms engaged in the business of transportation. Characteristically high property taxes on gas utilities increase gas rates to consumers relative to the prices paid for fuel oil. Similarly, property taxes are much higher proportions of railroads' expense structures than of those of other transportation businesses.¹ This latter feature of the property tax obviously tends to encourage the use of non-railroad means of travel and transportation. An income tax on business net profits would alleviate those inequities to the extent that its proceeds will reduce or avoid increases in real property taxes on such businesses.

Finally, the property tax has been a major factor in pushing farmers out of urban and suburban areas and in the conversion of prime agricultural land to urban uses. The imposition of a local income tax would most likely relieve some of this pressure. As regards the taxation of the

¹ Netzer indicates that in 1957, property taxes amounted to 4.9 percent of national income originating in railroad transportation, but only 0.04 percent of national income originating in air transportation and 2 percent in motor freight transportation.

income of farmers, however, a problem arises which requires further study to arrive at a solution. This problem is whether or how to tax imputed income, and non-monetary income, i.e., income in kind. The preceding listing of inherent weaknesses of the property tax should not lead to the unqualified conclusion that the income tax is without blemishes altogether. One which merits brief discussion is the problem of the income tax administration. In states such as New York, where an existing state income tax offers a ready vehicle for the attachment of a local income tax surcharge, the overall administrative costs should be fairly minimal. A significant cost burden, however, would have to be borne by business. The payment of municipal income taxes by business is, in general, less of a burden than is the additional bookkeeping and reporting required.¹ A substantial proportion of both businesses and employees have income attributable to more than one local taxing jurisdiction. This creates problems in regard to the determination of net profits generated in each specific taxing jurisdiction and the determination of which employees are residents of the taxing jurisdiction and therefore subject to withholding and which are not.

In addition to its previously discussed inherent defects, the property tax is also afflicted with a number of remediable shortcomings. The most significant of these is the existence of substantial property tax rate differentials and their resultant distorting effects on metropolitan land use patterns. An obvious remedy of this weakness is the spreading of

¹Lloyd E. Slater, "Evaluation of Municipal Business Taxes," in Municipal Income Taxes, APS, 1968, p. 113.

property taxes over wider geographic areas. This approach would reduce tax disparities by evening out differences in tax base per capita or per pupil and eliminate the extremely harmful economic and land use effects of the fiscal zoning game. Two approaches are frequently suggested to accomplish these objectives: (1) the consolidation of tax base components, and (2) a fiscal federation.¹

The first of these approaches would require the identification of certain types of properties, generally business property, the taxation of this tax base component at a uniform rate throughout a county, region or even the state,² and the redistribution of the proceeds of this tax to the individual school districts on the basis of some index of need and fiscal effort.

The second of these approaches, the fiscal federation, is perhaps best exemplified by the Metro Toronto School System. Under this method, state aid--provincial aid in the case of Canada--is paid to an areawide jurisdiction and the remaining net local burden is distributed in the form of a uniform tax rate³ throughout the component school districts of the federation. Uniform tax rates, however, do not necessarily have to be equated with uniform per pupil expenditure levels throughout a federation. This is certainly not

¹Dick Netzer, op. cit., p. 50.

²Mable Walker, op. cit., p.7.

³The tax rate in Metro Toronto is not precisely uniform due to the practice of allocating the Metro levy among the component districts on the basis of taxable and exempt valuation. The tax within the districts, of course, can only be levied against taxable property.

the case in Metro Toronto where the budgets of the individual component districts are reviewed by the Metro Board--which itself consists of representatives of the component boards--in terms of the specific needs of each individual district and where the average per pupil expenditure patterns do show significant variations.

SUMMARY AND CONCLUSION

Beginning with the premises of the dire needs for additional funds for local governmental public services and of the great difficulties to raise such funds from the mainstay of our local revenue system, the real property tax, this study has attempted to select a revenue alternative or supplement which would meet these needs and minimize tax inequities and taxpayer resistance. A discussion of basic principles of equity of taxation--the cost-benefit and the ability to pay principles--pointed to the conclusion that the latter of these offers the most logical justification for the financing of services whose ultimate impact and benefits are widely diffused and where the payment of costs by the immediate beneficiaries would be both impractical and impossible.

Public education is perhaps the best example of a function which should be supported equitably on the basis of ability to pay. The study has demonstrated that there exists virtually unanimous agreement that the best index of a person's ability to pay is his income. Thus a local tax on income appears to be the optimal local revenue alternative we have been searching for. Interestingly, the financing of public education with a tax on personal income not only satisfies the principle of ability to pay but, in some measure, also the principle of benefits received, albeit on a somewhat delayed basis, for a convincing argument can be made that a person's income and consequently his ability to pay is at least to some degree related to the benefits he has received from the public education function in the past.

A review of the history of the local income tax in the United States shows an accelerating trend towards the imposition of this tax in more and more jurisdictions, primarily our larger cities. In recent years, however, counties too have chosen to impose local income taxes. An analysis of existing local income taxes, a review of relevant literature and consideration of our own community's needs and special characteristics prompted the following findings and recommendations:

1. An income tax should be imposed within Monroe County for funding countywide educational purposes and for distribution among school districts to lessen dependence on and to equalize the burden of property taxation.
2. If used for educational purposes only, commuters should be exempt from this tax.
3. Difficulties of jurisdictional overlaps between the county and school districts can be overcome.
4. The tax should be imposed on earned as well as unearned income.
5. Business net profits should not be taxed at a higher rate than personal income.
6. The income tax should be a "piggy back" tax attached to the New York State income tax.
7. The rate of imposition should be a flat one percent on income in excess of exemptions and deductions.
8. The yield of a local income tax in Monroe County could range from \$22 million to \$48 million.
9. For educational purposes the local income tax is vastly¹ superior to the property tax in all aspects considered.

¹One additional advantage of the income tax not mentioned in the main body of the report is that, unlike the property tax component of their rents it may be deducted by apartment dwellers in computing their federal income tax obligations.

The inequities of our system of financing public education have grown worse year by year. State aid formulas continue to be unable to equalize property tax burdens up to a realistic expenditure ceiling, and to lessen the increasingly excessive dependence on property taxation. In view of the state's continuing fiscal dilemma, the best corrective result that may be expected from statewide studies, such as that conducted by the Fleischman Commission, is the elimination of some, perhaps many, of the inequities now inherent in the formula system, but hopes for substantially increased overall state aid outlays are dim indeed.

Our community has not advanced to where it is now by waiting for higher levels of government to show it the way. It has been and still is in many respects a leader in organization and functional reforms. We seem to have become aware of our needs and the extent of the needs more quickly than other jurisdictions, especially those at a higher level and we have been able to devise and implement effective remedies for these needs at the local level. Unless there is continuation of this tradition of constructive leadership, events may foreclose the opportunity for a rational countywide approach, for, to quote Elizabeth Deran: "...if the trend continues, by 1975 at least half of the metropolitan population of the United States will be subject to a city income tax."¹

¹Elizabeth Deran, "An Overview of Municipal Income Tax," in Municipal Income Taxes, APS, 1968, p. 26.

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